BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 2003-5-G - ORDER NO. 2003-652

NOVEMBER 17, 2003

IN RE: Annual Review of Purchased Gas Adjustments and Gas Purchasing Policies of South Carolina Electric & Gas Company.	))))	ORDER RULING ON PGA AND GAS PURCHASING PRACTICES

This matter comes before the Public Service Commission of South Carolina (the "Commission") for the Annual Review of the Purchased Gas Adjustment ("PGA") and the Gas Purchasing Policies of South Carolina Electric & Gas Company ("SCE&G" or "Company"). In addition, pursuant to Order No. 94-1117, the Commission has reviewed the collection of environmental clean-up costs ("ECC") for the relevant period.

By letter dated June 17, 2003, this Commission instructed the company to publish a notice (once, in a newspaper of general circulation, in the relevant review areas) advising all interested parties of the manner and time in which to file pleadings to obtain the right to participate in this review. The Commission further instructed SCE&G to provide direct notification of the PGA review to all of its customers affected by the review. The Company provided affidavits to confirm its compliance with the Commission's instructions. Following this notification, the Consumer Advocate for the State of South Carolina ("Consumer Advocate") filed a Petition to Intervene on June 30, 2003, and the South Carolina Energy Users Group filed a Petition to Intervene on September 3, 2003.

On October 16, 2003, the Commission held a hearing in this matter in its offices. The Honorable Mignon Clyburn, Chair, presided. SCE&G was represented by Francis P. Mood, Esquire and Dalhi N. Myers, Esquire. The Consumer Advocate was represented by Elliott F. Elam, Jr., Esquire. The Commission Staff was represented by F. David Butler, General Counsel. The South Carolina Energy Users Group did not enter an appearance at the hearing.

SCE&G presented the testimony of witnesses Martin K. Phalen, Daniel M. Ives, R. Dow Bailey, and Harry L. Scruggs. The Commission Staff presented the testimony of staff witnesses Roy H. Barnette and Brent L. Sires. The Consumer Advocate did not present testimony.

For the reasons stated herein, the Commission finds that SCE&G's purchasing practices for the review period were prudent, and therefore, approves the requested reduction in the fuel factor for the coming twelve month period beginning November 2003 and ending October 2004. The new factor of 87.656 cents per therm shall be effective as of the first billing cycle of November 2003. We also hereby approve a reduction in the ECC from 3.0 cents per therm to 0.8 cents per therm, which will extend the ECC and allow the Company to recover the liability based on estimated sales volumes by approximately 2009.

Summary of Testimony

Mr. Martin K. F Phalen

Martin K. Phalen, Vice President of Gas Operations for SCE&G, provided testimony regarding the operations and purchasing practices of SCE&G's natural gas distribution system for the review period. He explained the purpose of the Industrial Sales Program ("ISP") and discussed the current status of the environmental collection factor resulting from the clean-up of former manufactured gas plant ("MGP") sites. Finally, Mr. Phalen discussed the Company's gas purchasing practices and proposed new PGA factor.

Mr. Phalen briefly described SCE&G's gas distribution system, which consists of approximately 6, 600 miles of mains that carry natural gas to more than 275,000 homes, factories and businesses in 34 of South Carolina's 46 counties. Mr. Phalen stated that because the SCE&G system is geographically diverse, the Company operates and maintains approximately 192 metered delivery points for delivery from South Carolina Pipeline Corporation ("SCPC"), its supplier. The Company relies on SCPC to provide consolidated delivery of supply and to connect the numerous town border stations throughout SCE&G's service territory.

Mr. Phalen testified that SCE&G contracts with SCPC for a firm contract demand of 276,495 DTs per day and that the firm volume is used to serve its core market: firm residential, commercial and industrial customers. He stated that SCPC provides the procurement function for reliable delivery of natural gas volumes to SCE&G and that SCPC's experienced staff possesses the technical expertise to navigate the complicated, constantly changing issues involved in the purchase, transportation, and exchange of natural gas volumes on behalf of SCE&G.

Mr. Phalen stated that SCE&G has had its Supply Plan reviewed by an independent expert, Mr. Dan Ives, who concluded, consistent with SCE&G's findings, that SCE&G's practice of contracting with SCPC for its gas supply provides consumers with a diverse, reliable and reasonably priced source of gas at a cost comparable to that which the Company would incur if SCE&G made gas purchases on its own. Further, SCE&G's use of SCPC provides the Company with competitive, open market purchases without the added cost that SCE&G would incur if the Company were to procure and manage its own gas supply. He stated that changes to SCE&G's supply plan would result in the introduction of additional risks to customers in the area of capacity releases and unnecessary duplication of services.

Mr. Phalen noted that SCE&G also serves 375 interruptible industrial and commercial customers, who represent approximately 50% of SCE&G's total gas sales. These customers have elected to execute interruptible service agreements and have alternate fuels. An interruptible customer relies on an alternate fuel system for two reasons. First, in the event of a curtailment of natural gas service from SCE&G, which is usually due to extreme weather, the interruptible customer may utilize an alternate fuel to maintain operations for the duration of the natural gas curtailment. Secondly, if the weighted average price of gas from SCE&G is higher than the cost of the interruptible customer's alternate fuel, the interruptible customer would likely utilize its alternate fuel as opposed to burning natural gas. Addressing the latter situation, in 1983, the Commission approved the Industrial Sales Program Rider (ISP-R). Since that time, the ISP-R has been periodically reviewed and upheld by the Commission.

Mr. Phalen also testified that SCE&G operates and maintains two propane air facilities, which provide critical peak day injections of propane-air into the natural gas distribution system. The Lucius Road facility, located on the banks of the Columbia Canal, is capable of providing 50,000 mcf natural gas equivalent into the Columbia distribution system. The Leeds Avenue facility is located just north of the Charleston Peninsula and is capable of injecting 20,000 mcf natural gas equivalent into the Charleston distribution system. These facilities serve SCE&G's systems when necessary, and, with contracted demand, provide the company with an effective and reliable supply mix.

Mr. Phalen discussed SCE&G's continuing work to monitor and perform clean-up activities at various environmental clean up sites (with oversight from the EPA and DHEC). He described the Company's cumulative expenses to date as within revised estimates as presented to this Commission in prior PGA proceedings. However, the Company requested that the current amortization period be extended and the factor be reduced from its current level of 3.0 cents per therm to 0.8 cents per therm. This reduction will provide relief for customers and allow the Company to have an avenue available to it for the recovery of the remaining balance of these expenses and address any presently unforeseen circumstances.

Mr. Phalen requested approval of a new PGA factor of 87.656 cents per therm, which is a reduction over the current level of 92.780 cents per therm and is made possible because of lower levels of forecasted commodity prices of natural gas by the New York Mercantile Exchange (NYMEX). Mr. Phalen noted the fact that SCE&G entered the review period with a forecasted under-collection of nearly $31 million. An out of period adjustment, effective March 2003, in addition to better than forecasted prices, allowed the

Company to reduce that figure by two thirds. The current under-collection is forecasted to be $10,192,853 by October 31, 2003.

Finally, Mr. Phalen testified that SCE&G's purchasing practices are indeed prudent, striking a reasonable balance between reliability and price, and that the ISP-R continues to allow SCE&G to retain interruptible load while improving load factor and reducing system costs.

Mr. R. Dow Bailey

Mr. R. Dow Bailey, the Forecast Coordinator in SCANA Corporation's Resource Planning Department, discussed the construction of the Company's gas peak demand forecast. According to Mr. Bailey, the peak demand estimate used in this proceeding was ultimately the result of statistical models, customer projections, and weather inputs. When these components were combined, the result was an estimate of 327,770 MCF for peak day conditions.

The forecasting model was developed using data from this past winter, 2002-2003, when a new gas peak demand of 277,511 MCF was established on January 23, 2003. The previous record daily sendout for firm customers was set nine years ago during the 1993-1994 winter. Two regression equations were developed based on the new peak demand data, using actual customer counts and weather with excellent results. On the peak day, model estimates were within 3.4% of actual sendout.

Mr. Bailey stated that in addition to having an accurate model for a recent year, the ability to incorporate changes in the major factors affecting SCE&G's peak demand also was required. A key element here was SCE&G's firm customer base. Over time this group not only grows; it changes in composition. To capture these changes in customer mix and size, another group of equations was developed to sub-divide the two major firm customer groups into nine smaller ones, so the forecast model was now expanded to nine forecasting equations of average daily use per customer. These models could then be combined with customer projections, which have averaged less than 0.2% annual error in recent years, to estimate an unadjusted peak demand.

Another major factor which was incorporated into the average use portions of the models was furnace replacement. Beginning in 1992, all furnaces shipped by manufacturers were required to be at least 78% efficient, and now generally average 85% efficiency. Thus, on average, new or replacement customers will use less gas on a peak day than those with older furnaces. Therefore, the customer projections for the nine class/rate groups were also split into existing, new, or replacement customer categories. SCE&G made calculations to adjust the peak day use estimates for savings due to higher-efficiency furnaces, and these calculations also were added to the model structure.

The third component in the forecast was reasonable values for the weather inputs used in the models. Using data from the past 24 years, the coldest days on the SCE&G system were determined and ranked, after being calculated on a gas-day basis, *i.e.*, from 10AM to 10AM rather than midnight to midnight. This time-frame contains some of the coldest weather on record, as well as some of the mildest. Based on that record, it was determined that an average of the 3 coldest days would best represent the peak day design temperature. Combining the three elements of model, customers, and weather resulted in the winter 2003-2004 projection of 327,770 MCF, which was then translated to 342,821 DTs after pipeline losses and conversion to BTUs.

Mr. Daniel M. Ives

Mr. Daniel Ives, a consultant with Lukens Energy Group in Houston, Texas, testified on behalf of the Company. Mr. Ives presented an overview of the natural gas commodity markets and discussed (1) the Company's utilization of SCPC's intrastate pipeline system, (2) the benefits the Company derives from SCPC's intrastate pipeline system, (3) the reliable, diverse gas supply portfolio SCPC provides to the Company and the advantages of SCPC's reliable, diverse gas supply mix, (4) the prudence and reasonableness of SCE&G's purchased gas costs, and (5) the Company's responsibilities were it to purchase its own gas supply.

Mr. Ives testified that SCE&G takes delivery from SCPC at SCE&G's 192 metered delivery points across the state. He noted that no other pipeline infrastructure exists in the state that could deliver gas to all 192 delivery points. He stated that the Company's purchases from SCPC are made under SCPC's tariffs at rates that are reviewed and approved by this Commission. SCPC contracts with some 70 gas supply and transportation companies. At any given time, SCPC's purchases in the interstate natural gas markets are made at market-based rates from approximately 30 creditworthy suppliers, under hundreds of contracts during the year. SCPC transports its gas purchases to South Carolina using firm transportation capacity on each of the two interstate pipelines that serve the state. SCPC also utilizes interstate storage services and SCPC's own on-system LNG facilities to provide reliable firm supplies to the Company and other firm customers.

The Company's gas purchase cost is based on a pass-through of SCPC's prudently incurred cost of gas, as reviewed and approved by the Commission, and SCPC's upstream interstate transportation and storage charges, which are reviewed and approved by the Federal Energy Regulatory Commission ("FERC").

Based on Mr. Ives' review of SCE&G's overall gas purchasing practices and the diversity of its gas supply, Mr. Ives concluded that the Company's practice of contracting with SCPC for its gas supply (1) provides customers a diverse, reliable, and reasonably priced source of supply at a comparable cost to that which the Company would incur should it choose to purchase its own gas in the marketplace and (2) provides the benefits of competitive, open market purchases without the need for the Company to acquire people and other duplicative resources to procure and manage its own gas supplies.

Mr. Ives testified that the Company's purchased gas costs are prudent and reasonable because: (l) the Company's gas purchases are made by SCPC at market-based commodity prices; (2) the transportation costs included in the Company's purchased gas cost are based on FERC-approved interstate rates and Commission-approved intrastate rates; and (3) SCPC's hedging activities, ISP-R sales, capacity release transactions and other activities are subject to on-going review and approval by the Commission. His testimony was that SCE&G's use of SCPC as a supplier provides South Carolina customers with a diverse mix of reliable natural gas supply, at market-based prices and that there is no present justification for the Company to independently obtain firm transportation service and contract directly with gas marketers and suppliers. Mr. Ives also noted that SCE&G's bifurcation of the gas purchasing function would be in contrast to the industry trend, which is to centralize services and realize efficiencies.

Mr. Harry L. Scruggs

Mr. Harry Scruggs, Senior Rate and Regulatory Specialist in the Gas Rate Department of SCE&G, explained the operation of the Industrial Sales Program (ISP) and discussed the status of the environmental clean up cost factor and the Company's forecasted cost of gas.

Mr. Scruggs testified that all SCE&G customers benefit from SCE&G's use of the ISP because the margins collected help to offset the fixed costs of doing business. He explained that without the ISP-R, SCE&G could not effectively compete against alternate fuel prices. Because of the ISP-R, interruptible customers have remained on the SCE&G system and have continued to purchase natural gas volumes from SCE&G. Mr. Scruggs opined that hese same customers would likely have switched to an alternate fuel absent the ISPR.

In addition, margin revenues from interruptible customers cover a portion of SCE&G's fixed costs. Without the competitive sales provided by the ISP-R, more fixed costs would be borne by SCE&G's firm customers. As a result, the margin charged to SCE&G's firm customers (most of which are residential) would be higher. During the period of September 2002 through August 2003, the margin revenues generated by the ISP-R program were over $12,000,000. The ISP customers are able to utilize natural gas as a fuel because of the competitive pricing provision in their contracts.

Mr. Scruggs stated that SCE&G is requesting a reduction in the level of the ECC factor from 3.0 cents per therm to 0.8 cents per therm. Once approved, customers would see this 2.2 cents per therm reduction in their rates beginning with the first billing cycle of November 2003.

Mr. Scruggs then discussed the Company's forecasted cost of gas. The next annual review period begins in November 2003 and ends in October 2004. SCE&G's gas cost forecast begins with the purchasing profile of the historic actual 12-month period ending August 2002. From that point, the company applies the current NYMEX futures prices and then makes adjustments for future known and measurable changes. A projected monthly gas cost was developed and applied to SCE&G's monthly firm forecasted sales. The result is an average annual cost of gas of 83.568 cents per therm. A true-up factor, for the prior period, of 4.551 cents per therm was then added to recognize the forecasted under-collection balance at the end of October 2002 of $10.2 million dollars.

The Company's forecasted gas cost, plus the prior period true-up, produces an annual levelized PGA of 87.656 cents per therm, which Mr. Scruggs requested this Commission approve. The new factor represents a reduction of 5.124 cents per therm. When coupled with the ECC factor decrease, a residential customer using 600 therms would see their annual bill reduced by about $44 or 5.8%. This purchased gas cost would be incorporated in SCE&G's firm tariff rates for the billing months of November 2003 through October 2004.

Mr. Roy L. Barnette

Mr. Roy Barnette, an Auditor with the Commission, testified on behalf of the Commission staff. Mr. Barnette summarized the Audit Staff's findings and stated that Staff had verified SCE&G's gas costs and Environmental Cleanup Costs for the test year ended August 31, 2003. According to Barnette, the cumulative net under-collection, as of October 31, 2003, is $10,192,853. SCE&G's total environmental liability is $57,000,000. After deductions of $33,392,430 for amortization and collections, and $12,388,698 from insurance commitments, the outstanding balance to be collected for Environmental Cleanup Costs through the PGA is $11,218,872. Barnette also testified that SCE&G was correctly recovering its gas costs pursuant to its approved tariffs.

Mr. Brent Sires

Mr. Brent Sires, Chief of Gas in the Commission's Utilities Department, also testified on behalf of the Commission Staff. Mr. Sires presented the Utilities Department's findings and recommendations resulting from its analysis of the Company's gas purchasing policies, Industrial Sales Program, and the cost of gas factor for the period November 2003 through October 2004.

Mr. Sires stated that the Company uses a levelized cost of gas component in its published tariff rates, which allows the Company to project its cost of gas over a twelve month period. On a monthly basis, the Company records (in a deferred or unbilled account) the difference between the cost of gas as collected from its customers and the actual cost of gas incurred by the Company. The Company files monthly reports on this account with the Commission to keep the Commission informed on the activity in that account. The account reflects the net accumulation of over or under collection of gas costs from SCE&G's customers, and the net variance in the account is treated as a true-up provision. The accumulated over or under recovery is recovered or credited in the succeeding twelve month period.

The approved procedure also allows for out of period adjustments should significant, unanticipated changes to the Company's cost of gas arise. During the current review period, SCE&G filed a petition for approval of an out of period adjustment to the levelized cost of gas component. That petition was granted, and in March of 2003, SCE&G implemented a new cost of gas component and increased the levelized cost of gas component from $0.72788 per therm to $0.92780 per therm, the current effective rate.

Mr. Sires described the factors contributing to the Company's under-recovery during the review period. The first contributor was the impact resulting from hedging losses. During the review period SCE&G had forecasted hedging gains approximately $3.4 million less than actual gains. The second contributing factor was the recovery of fixed demand and commodity cost of gas. The review period was significantly colder than normal resulting in greater sales volume to spread the fixed capacity cost over and the recovery of gas cost in the levelized cost of gas component. The third factor was the actual NYMEX closing price applicable to each month in the review period compared to the latest NYMEX strip prices that were available when the forecasted gas cost was developed in the preceding PGA review proceeding and the out of period adjustment effective in March 2003.

Mr. Sires noted the Company's requested reduction in the ECC and stated that the Staff takes no exception to the requested reduction. He stated that he appreciated the Company's continuing desire to explore avenues to mitigate the high price of the natural gas commodity passed along to consumers through the per therm billed rate.

Mr. Sires discussed the prudence of SCE&G's use of SCPC and stated that, in the opinion of the Utilities Department, SCE&G receives adequate supplies of firm gas to meet its captive customers' needs and is prudent with regard to its purchases of gas supplies from SCPC. He stated that, in light of the many changes which continue to take place which affect the securing and transportation of gas, SCE&G should continue its ongoing program to ensure that its gas supply is consistent with its customers' needs and to ensure that supply efficiency is maintained at reasonable costs.

Finally, Mr. Sires stated that the operation of the Company's ISP program should continue, since this mechanism allows SCE&G to compete with alternate fuels.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Based on the evidence in the record, the Commission makes the following findings and conclusions:

1) We find that SCE&G's gas purchasing practices for the period under review are prudent and that SCE&G has properly recovered its gas costs pursuant to the terms and conditions of the Company's approved tariff. The direct testimony of Company witness Phalen, Company witness Ives, and Staff witness Sires specifically support this conclusion.

Mr. Phalen notes that SCE&G purchases its gas from SCPC under tariffs approved by this Commission. Further, the operation of the SCPC system is backed by much experience among the various members of its knowledgeable Staff.

Mr. Ives testified that, based on his independent review of SCE&G's overall gas purchasing practices and the diversity of its gas supply, the Company's practice of contracting with SCPC for its gas supply provides customers a diverse, reliable, and reasonably priced source of supply at a comparable cost to that which the Company would incur should it purchase its own gas in the marketplace and provides the benefits of competitive, open market purchases without the need for the Company to acquire people and other duplicative resources to procure and manage its own gas supplies.

Mr. Ives further stated that the Company's purchased gas costs are prudent and reasonable because (a) the Company's gas purchases are made by SCPC at market-based commodity prices, (b) the transportation costs included in the Company's purchased gas cost are based on FERC-approved interstate rates and Commission-approved intrastate rates, and (c) SCPC's hedging activities, ISPR sales, capacity release transactions and other activities are subject to ongoing review and approval by the Commission.

According to Mr. Ives, SCE&G's use of SCPC as a supplier provides South Carolina customers with a diverse mix of reliable natural gas, at market-based prices, and there is no present justification for the Company to independently obtain firm transportation service and contract directly with gas marketers and suppliers. No party challenged this testimony. In support of the Company's position, Staff witness Sires stated that, in the opinion of the Utilities Department, SCE&G receives adequate supplies of firm gas to meet its captive customers' needs and is prudent with regard to its purchases of gas supplies from SCPC. He stated that, in light of the many changes which continue to affect the securing and transportation of gas, SCE&G should continue its ongoing program to ensure that its gas supply is consistent with its customers' needs and to ensure that supply efficiency is maintained at reasonable costs.

We find no evidence in the record to contradict the testimony of Mr. Phalen, Mr. Ives or Mr. Sires on the issue of SCE&G's prudence regarding its use of SCPC to purchase gas. We specifically find that SCE&G's purchasing practices are prudent and provide a reliable source of reasonably priced gas to meet its customers' needs.

2) The base cost of gas for the coming period shall be 87.656 cents per therm effective beginning with the first billing cycle in November 2003. The testimony of witnesses Scruggs and Sires support this conclusion.

Mr. Scruggs provided historical data for the review period September 2002 through August 2003 and provided computations for the projected cost of gas per therm for the coming period, September 2003 through October 2004. After all calculations are reviewed, the conclusion is that the base cost of gas should be decreased to 87.656 cents per therm. The direct testimony of Staff Witness Sires supports Mr. Scruggs analysis, and the Commission finds no contradictory evidence in the record.

3) The Company shall reduce the level of the ECC factor from 3.0 cents per therm to 0.8 cents per therm and the amortization period for the ECC shall be extended to 2009. We would note that this disposition of the ECC factor does not remove the responsibility of the Company to clean up the manufactured gas plant sites. The reduction

in the FCC will provide relief for customers while providing an avenue for the Company to recover the remaining balance of these expenses and address any presently unforeseen circumstances. The reduction of 2.2 cents per therm shall be effective beginning with the first billing cycle of November 2003. The uncontroverted testimony of Company witnesses Phalen and Scruggs and Staff witness Sires specifically support this finding of the Commission.

4) The current industrial sales program shall be continued. The value of this program to the Company's firm customers was discussed by Company witnesses Phalen and Scruggs, and the evidence supporting this finding was uncontroverted. Staff witness Sires also expressed support for the continuance of the program.

5) We find that SCE&G shall continue to file with this Commission quarterly updates related to review of the benefits of diversifying SCE&G's natural gas supply as required by Order No. 2002-747 in Docket No. 2002-5-G and as described in Order No. 2002-747 and Order No. 2002-837.

(6) The tariffs and rate schedules shall be filed reflecting the findings herein within five (5) days of the receipt of this Order by the Company.

(7) This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

Mignon L. Clyburn
Chairman

ATTEST:

Bruce F. Duke
Deputy Executive Director

(SEAL)